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SUBJECT: CONSUMER CREDIT BOOM FUELS ECONOMIC GROWTH IN ROMANIA

SUMMARY

1. The consumer credit market is booming in Romania, with lending institutions offering a wide and growing range of products reaching a total volume of \$4.7 billion in 2004. The resulting shopping frenzy has contributed to an increase in retailers' profits, as well as a jump in the country's foreign trade deficit as consumers rush to buy foreign goods. So far, in spite of consumer protection groups' fears to the contrary, delinquency rates are low. However, loan recovery firms are doing brisk business as the number of the over-extended grows. Romania's first fully-functioning private credit rating agency began providing consumer data to lenders in April, and credit scoring will begin in the short term. Rural consumers, considered high-risk by lenders, have been left on the sidelines, unable to qualify for most loans.

Banks Drive Credit Boom in Romania.

2. Consumer credit has been available in Romania since the fall of communism, although hyper-inflation, high interest rates, substantial collateral demands and economic uncertainty limited the growth of this market. It was not until 2002 when basic consumer loans and home mortgages became commonplace, with the total loan portfolio for that year in the low hundreds of millions of dollars. Consumer lending momentum soared over the next two years in tandem with Romania's increasingly rosy economic indicators. By year-end 2004, total consumer lending reached \$4.7 billion, an increase of 6.5 times over 2002. This boom is indicative of the pent-up consumer demand characterizing the product-poor Romanian marketplace in the late 1990s and early 2000s. Increasing competition among financial institutions has lowered annualized interest rates from more than 100 percent in the mid-1990s to as low as 17 percent today.

3. Loan products have grown in breadth and sophistication over the past three years and today banks offer not only basic loans, such as home mortgages, but also loans for cars, home appliances, vacations and "personal needs". Real estate developers expect approximately 80 percent of home residences to be financed this year by mortgage loans. Home lending is further expected to expand once the secondary mortgage market opens allowing banks to offload risk. Use of credit cards is also on the rise; by year-end 2004 total credit card transaction volume reached \$6.5 billion (up 46 percent from 2003), generated by 117.6 million transactions. Slightly more than five percent of consumers currently use credit cards, and a fifth of the population regularly pays with debit cards. Consumers like the new product selection, and surveys show that high numbers expect to enter into credit agreements by year-end 2005. Loans for household goods lead the pack in popularity with 5.3 percent of all consumers planning to borrow.

4. The fast pace of lending has contributed to Romania's impressive GDP growth, which stood at 8.3 percent last year. The construction and retailing sectors have benefited in particular. In the first quarter of 2005 retail sales jumped 18.7 percent over 2004, demonstrating this trend. However, some analysts fear short-term overheating. The IMF points to a growing current account deficit linked to high imports from abroad.

.While Non-bank Financial Institutions Follow Close Behind

5. Although slightly more than fifty percent of all consumer loans continue to be generated by banks, non-bank financial institutions (NBFIs), many of which operate in close partnership with Romania's retailing giants, have gained substantial market share within the last three years. These institutions' high profit margins on electronics and home appliance loans have made them popular take-over targets, and several were recently acquired by Western European and American investors. The rapid growth of NBFIs prompted the GOR to pass law 289/2004 "Concerning Credit

Agreements", which requires them to acquire licenses and observe consumer credit rules including pre-contractual disclosure, annual percentage rate calculation, and agreement to advance repayment. Previous to this law, NBFIs were completely unregulated. NBFIs still operate outside of Romania's banking regulations which limit total loan amounts.

16. Applying for credit in-store can take as little as 15 minutes and retailers are quick to encourage this extra source of revenue. Romanian hypermarkets and home appliance retailers currently average 60 to 70 percent of their sales volume on credit, depending on seasonality and customer base. Household goods, electronics and furniture see the largest growth with an average purchase amount of 500 Euros. Romania's comparatively low incomes require loan maturities on consumer goods up to five times as long as those in the Czech and Polish marketplaces.

17. Romanians have an overall cultural aversion to owing money, and approximately seventy percent of borrowers pre-pay their loans, an unusually high number. Many, in particular the elderly, avoid credit due to their lingering fear of financial institutions and distrust of contractual agreements. Romanians tend to pay on time and delinquency rates hover around three to five percent, which both NBFIs and traditional banks consider low for a developing market. Banks which carefully screen applicants according to income level and credit history claim non-payment rates as low as 0.5 percent.

Debt Collectors Rush to Cash In

18. The credit boom has benefited debt collectors who saw a 300 percent growth in their consumer business in 2003. As consumers take on more debt and are unable to pay, both banks and NBFIs offload these delinquent payers to debt collectors. The main market players use generally accepted business practices, first attempting contact by phone and mail which generates a success rate of around 40 percent. If demands for payment are unsuccessful, the debt collector brings the case to court. The vast majority of loans in arrears, around 85 to 90 percent, are less than \$1700. Personal needs loans see the highest level of default, followed by loans for consumer goods. Mortgages and car loans have the lowest default rates, of around two percent.

Rural Dwellers Snubbed as High Risk

19. Rural residents have been left out of the lending boom for a variety of reasons, including a lack of banking branches and department stores in Romanian villages, income from undocumented sources, such as farming; and greater reliance upon foreign remittances transferred by relatives abroad. State-owned Banca Comerciala Romana (BCR) claims that it services ninety percent of the market, although the bank's total rural market portfolio is merely \$10 million. Most NBFIs target cities with populations exceeding 50,000; they view investment in poor, rural areas as unlikely to generate required returns. The GOR has investigated programs to promote crop receipts as collateral for bank loans, but so far this initiative has made little progress.

Uneven Legislation To Conform with the EU

10. Legislation in the consumer credit sector is a mixed bag; most laws are geared towards consumer protection, while financial institutions remain frustrated by the absence of strong penalties for non-payment of debt. There is no expedited process within the legal system for financial companies and cases typically take six months to a year to be heard by a court. In addition to the Law Concerning Credit Agreements, which protects consumers who enter into credit agreements, the Romanian Parliament has passed laws on data protection conforming to EU legislation. Commercial banking norms have also been passed which stipulate that down payments on goods must represent at least 25 percent of the item's respective value. Additionally, total monthly payments can not exceed 30 percent of the customer's net monthly income, or 35 percent for home mortgages. Interestingly, these income constraints have resulted in employers bowing to pressure from workers to report full income to the state, rather than paying under the table to avoid payroll taxes.

11. However, gaps in legislation remain; NBFIs are not subject to the same lending caps as banks, nor subordinate to banking regulations or supervision. Commercial banks are frustrated by this uneven playing field and seek to convince the Central Bank to relax the lending restrictions, although a change is unlikely. Clarification on laws pertaining to overextended borrowers are also needed - no bankruptcy law exists, nor is there any way for lenders to "fast-track" cases of non-payment through the court system.

Consumer Credit Bureau to Track and Score Consumers.

12. Until very recently, only the National Bank of Romania tracked consumer credit, although only bad debts exceeding approximately \$6,800 were recorded. The Bank began collecting this data in 2000 upon request of the IMF, which was concerned about a dearth of statistics on outstanding loans. In response to the growing demand for customer data, last year a group of 27 financial institutions, representing 95 percent of the credit market, founded a first-of-its-kind private credit rating agency. As of April 2005, this group succeeded in compiling a comprehensive database of both positive and negative customer information from financial companies, insurers, leasing firms, telecommunications companies, and debt collectors.

13. Credit providers who are members of the agency and have agreed to its system of reciprocity can now request information on potential customers categorized into three groups: "good payment history", "bad payment history" and "overextended". The agency is now working with foreign scoring specialists to hone the current data base and develop a scoring system based on three years of positive and negative data. The success of this agency, as well as announcements of competitors that may enter the market, have prompted the National Bank to begin scaling down its credit tracking operations. The credit bureau's initiative has brought cries of protest from consumer protection groups concerned about data privacy. In response, the Romanian Parliament established a National Supervisory Authority to oversee the proper use of personal data and passed legislation conforming to EU data privacy norms.

.While Consumer Protection Concerns Grow

14. Econoff met with representatives of the Romanian Consumer Protection Agency (ANPC) who expressed concern about a lack of consumer credit education and need for data protection. They fear consumers falling prey to predatory lenders who sprinkle their contracts with unfamiliar legalistic terminology and pressure clients to sign. The agency also cited examples of unscrupulous lenders stipulating penalties of up to thirty percent of the total value of a loan for delinquent payers. Consumers are generally uninformed about the pros and cons of credit products and the elderly and young are particularly at risk. Bankruptcy laws do not currently exist for the overextended, although the agency was unaware of debtors being sent to prison for nonpayment. Another concern of the ANPC is the possible inappropriate use of and access to credit rating scores. With this in mind, the agency is now focusing on supervision of NBCI's and citizen education via television and press. The ANPC pointed out the general lack of consumer education on lending and admitted that their 42 offices have just begun to understand and appreciate this problem.

15. To assist the process of consumer education, Econoff organized a digital video conference (DVC) in May between the RCPA and representatives from the Federal Trade Commission to address consumer credit issues and explain how the Fair Debt Collection Practices Act operates in the United States. The RCPA greatly appreciated the session, and US Embassy Bucharest plans to request additional funds for a speaker program to target RCPA branch offices throughout the country.

Comment

16. Romania is developing a thriving consumer lending market which is so far remarkably stable in spite of the country's dearth of clear legislation and consumer education in this area. This market has fueled job growth in the retail and construction industries and allowed relatively low income Romanians to acquire needed housing and automobiles, further fueling the economy. To date, Romanians have handled debt prudently overall, partially due to their cultural aversion to owing money, as well as a fear of unforeseen future financial instabilities. The creation of the credit rating agency will assist lenders identify the overextended and steer them away from high risk individuals.

17. More troubling is the uneven legislation which caps the amount of total loans extended by banks, but places no restrictions on NBFIs, creating an uneven playing field. Data privacy is also a concern, as is the lack of education for young consumers on the healthy use of credit. Data is currently being collected for credit scoring purposes, unbeknownst to the general public, although the Consumer Protection Agency has recently taken an interest in this issue.

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